LOGAN TELEPHONE COOPERATIVE
The World At Your Fingertips

August 27, 2012

Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

To whom it may concern:

I am writing today on behalf of Logan Telephone Cooperative ("Logan"). Logan is a rural rate of return ILEC headquartered in Auburn, Kentucky. Logan operates six exchanges in a rural service area in south central Kentucky, covering approximately 514 square miles. As of December 31, 2011 Logan served approximately 5328 customers with voice and broadband services. Logan began operations in 1954 and serves customers in the area with a combination of fiber transport and copper loop facilities.

Logan is writing to seek a complete understanding of the limitations on capital expenditures placed on Logan by the Federal Communications Commission pursuant to the Regression Model and formulas released on April 25, 2012. When the FCC released the *Regression Order* Logan was not impacted by the regression based limitations in 2012. However, due to changes in loop counts and the undepreciated plant factor as of December 31, 2011, it now appears that Logan's universal service recovery will be reduced by approximately $28.08 per loop in 2013.

Logan has made every attempt to maximize its existing copper loop plant and to manage its network efficiently. Indeed, under the structure of the new caps, Logan has in a sense become "trapped" by its efficiency in network management, rendered ironically unable to invest because its use of existing copper plant has resulted in a lower capex limit than would have been the case had it invested more aggressively in new plant. Logan thus submits this correspondence to highlight what must be considered "the depreciated plant trap" arising out of the new caps. Specifically, Logan seeks an explanation as to: (i) why the regression models would place any limit on Logan's capital expenditures given the facts described herein, and (ii) what options, if any, it has to upgrade its network plant over time to respond to consumer demands and ensure "reasonably comparable" services.

Logan has been very conservative in the last several years regarding capital expenditures. Previously Logan upgraded our local network from 1996 to the early 2000's by adding fiber and electronics to shorten copper loop lengths to 18,000 feet in two exchanges and to 15,000 feet in the remaining four exchanges. Despite remaining conservative with capital expenditures as the FCC approached USF and ICC reform, Logan currently provides 4Meg/1Meg broadband to over 99% of our service area. Logan has not yet invested in fiber-to-the-home technologies, but will need to add capital expenditures in the near future to increase broadband speeds to those customers that live at the end of the longest copper loops. Logan currently has customers requesting speeds above what we can offer today and the demand for broadband speeds will continue to rise rapidly.

Logan has been very efficient by maximizing the service offerings provided to customers over our existing network rather than building networks with more capacity than customer demand has

warranted in the past. Logan has not retired a great deal of plant, but has instead put its existing plant to good use wherever possible in providing broadband service to customers. As a result, Logan's undepreciated plant percentage is lower than other companies that have recently built fiber-to-the-home networks and retired some or all of their copper facilities. Companies that have made more recent investments in facilities would see growth in their undepreciated plant percentage while Logan's undepreciated plant percentage is declining because we are making efficient use of our existing network to provide broadband services to customers.

Logan has also been efficient in our switching expenditures – and this too has ended up having the perverse effect of resulting in harm under the new caps and other recent reforms. Logan has installed one IP softswitch that replaced three switches and three remotes in our six exchanges. This has allowed for additional savings in operating expenses. However, when six switching centers are combined to one, the interoffice plant becomes loop plant that extends now from the single switch into each exchange. This change increased our company's loop length, and thus our cost per loop. As a result of this network re-engineering to minimize switching expenses and migrate to an IP-enabled platform, Logan is punished under the reforms. Because our cost per loop has increased in the face of new caps that punish carriers with high levels of depreciated plant, Logan loses USF revenues as described above. In short, Logan receives no benefit of the reduced operating expenses it has experienced due to efficient operations and the FCC's reforms have the perverse effect of punishing efficiency. We expect that this will not be an isolated case. Moreover, because the recovery mechanism dwindles over time by automatic reductions, companies will now be encouraged to minimize their costs by avoiding the procurement of new IP-enabled switches. Certainly, the FCC did not intend either result, and it must consider more closely how the mechanics of its reforms are actually working at clear cross-purposes with its stated reform objectives.

Finally, Logan is at a disadvantage under the new caps because it did not apply for any stimulus funding. We were unable to do so because our customers did not qualify as unserved or underserved. Logan was already delivering broadband throughout our customer base. Companies that receive grant moneys, however, will have an advantage in the regression analysis because their cost per loop will be lower than other similar companies that did not receive grant dollars, even though the capital expenditures of those grant recipients might be higher than a similarly situated company. There is nothing in the regression model that offsets this condition, and Logan and other companies will be unfairly penalized by serving customers without the use of stimulus grants.

Observations and Request for Explanation:

The imposition of a limit on Logan's Capex seems completely counterintuitive to the FCC's goal of efficiency, and it will hamstring Logan's efforts to upgrade over time as needed. A review of Logan's operating history and Logan's cost statistics demonstrate that Logan is an efficient company who makes effective use of plant in service and ranks in the lower forty percent of operating expense per loop for 2010.

Logan's Capex cost per loop *declines* by 2.7% from 2010 to 2011 but the Capex limit is reduced by 11.2%, or $77 per loop, resulting in Logan being limited by this regression Cap for 2013 disbursements. It seems the change in undepreciated plant unfairly reduces the Capex limit by too great an amount. Logan's undepreciated plant factor declined by only 4.1% but the Capex limit is reduced by 11.2%. This is just one example of how the regression based model adopted in the *Regression Order* produces unpredictable results, making it impossible for carriers to forecast future limitations and support. The

result is a decrease of $59,281 in Logan's High Cost Loop Support in 2013. As the full amount of regression limits are phased in, losses in 2014 will be substantially greater, especially if Logan is not eligible to receive redistributed support as a result of the regression limitation.

Logan has not deployed Fiber-to-the-Home but is being penalized for not retiring old plant and replacing it with new. The percent undepreciated plant factor is important for companies that are new in their life cycle, but it can be punitive to well-established companies that have not needed additional capital expenditures to meet customer broadband demand.

Logan requests an explanation of the logic behind the regression model's limitations; specifically the coefficient relationships that lead to Logan's Capex related costs exceeding the regression limits. Logan will be glad to provide our cost study detail information to the commission to help answer these questions. At a minimum, Logan would like responses to the following questions:

1. Why does Logan's percent of undepreciated plant factor obtain so much weighting in the regression model and cause Logan's Capex limitation to be reduced by 11.2% based on 2011 costs?

2. What caused Logan's Capex CPL to become limited by regression when in fact Logan's Capex Cost per Loop declined from 2010 to 2011?

3. Why does Logan not receive some benefit from being 21.9% below the Opex limitation threshold?

4. What can Logan do in future years to reduce the impact of the undepreciated plant factor?

5. Why is a company that, in 2010, had a SACPL ranked 429 out of 726 study areas, or at the 59th percentile, and hasn't made any substantial changes in costs, being limited by regression at all?

6. Does the commission plan to further modify the regression in the future to account for other differences in company cost per loop including state depreciation factors and stimulus grants?

7. Why does a company that attempted to achieve greater efficiencies by reducing its number of switches in service and deploying an IP-enabled softswitch platform face a penalty in the form of CapEx constraints? Is this the Commission's intended result of reform, and if so, how does the commission address the fact that this will be a deterrent to such switch migration going forward?

8. What options, if any, does Logan have to upgrade its network plant over time to respond to consumer demands and ensure "reasonably comparable" services? How can Logan know have any reasonable assurance of how its cap may change if it undertakes such investments?

Summary:

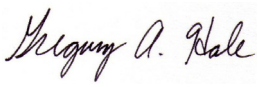
The mechanics of the Commission's reforms are not achieving its stated objectives. The mechanics punish efficiency by creating a "depreciated plant trap" – placing lower caps on carriers who have managed existing plant efficiently and thus precluding them making the incremental investments needed to upgrade plant over time. Specifically, in the *Regression Order*, the Bureau concludes that

carriers with more depreciated plant or "aging plant" deserve less high-cost support. This conclusion penalizes companies like Logan that efficiently use older plant such as copper cable in conjunction with newer technologies like fiber optic facilities to provide broadband to customers. While it is possible our cap might change as investments are made and depreciated plant is replaced, we cannot determine how it might do so with any assurance that enables reasonable planning.

Logan believes that the depreciated plant ratio, while based on readily available data and easily calculated, significantly fails as a predictor of excessive spending or universal service support needs. Had Logan simply replaced useful, yet aging plant two years ago – a decision that would have been wasteful and imprudent – it might have more room under the FCC's regression model Capex limitation. This result does not make sense and is contrary to the Commission's intention that the Bureau develops incentives for rate-of-return carriers to "invest prudently and operate efficiently."

Please provide this information and guidance as soon as possible. This information is critical for Logan in our budgeting and planning process that will take place in the next few months and is also critical for our development of the five year plan that the commission will require us to file next year.

Sincerely,



Gregory A Hale
General Manager

cc: Chairman Julius Genachowski
Commissioner Robert M. McDowell
Commissioner Mignon Clyburn
Commissioner Jessica Rosenworcel
Commissioner Ajit Pai
Bureau Chief Julie Veach